



August 15, 2007

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. OP-1288

Dear Ms. Johnson:

The Conference of State Bank Supervisors (CSBS) commends the Board of Governors of the Federal Reserve System (Board) for holding a public hearing to examine the adequacy of existing regulatory provisions and the Board's statutory authority to address certain loan terms and practices. We appreciate the Federal Reserve requesting state bank regulators and state attorneys general to testify on their extensive experience on this issue. We also appreciate the opportunity to submit a formal response on behalf of state bank regulators.

I. State Regulation of the Mortgage Market

The states, through CSBS and the American Association of Residential Mortgage Regulators (AARMR) have embarked upon many cooperative initiatives designed to improve supervision of the state-regulated portions of the residential mortgage market. Please see the appendix for a summary of the initiatives undertaken by the states.

II. Need for HOEPA Rulemaking

In response to the Board's solicitations on whether it should use its rulemaking authority under the Home Ownership and Equity Protection Act (HOEPA), CSBS encourages the Board to address concerns about the loan terms or practices listed below. CSBS strongly supports recent statements by Chairman Bernanke that the Federal Reserve intends to promulgate rules in this area, as rules are necessary to protect borrowers from abusive loan terms. HOEPA rulemaking is especially appropriate because these rules will cut across jurisdictional lines and uniformly address widespread problems in the marketplace.

Escrow for Taxes and Insurance

In order to promote sustainable homeownership, subprime¹ loans should typically include escrows for the payment of taxes and insurance. It has been our experience that

¹ "Subprime" and "subprime loans" are defined by the 2001 *Interagency Expanded Guidance for Subprime Lending Programs*. To promote consistency and uniformity, CSBS supports these definitions for the purposes of this comment letter.

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many borrowers do not understand that their payments do not include taxes and insurance and, without escrows, can not meet their responsibility to pay taxes and insurance when they come due. CSBS suggests that the Board utilize its authority under HOEPA to require lenders to escrow for taxes and insurance on all subprime loans.

Stated Income or Low Documentation Loans

Both the interagency and the CSBS/AARMR/NACCA Subprime Statements urge lenders to verify and document a subprime borrower's income, assets and liabilities. For the protection of investors, lenders, and borrowers, stated income or low doc loans should not be sold to subprime borrowers. Consequently, CSBS suggests that the Board prohibit stated income or low doc loans for subprime borrowers unless there are clear mitigating factors to offset the need for direct verification of income. In addition, even for loans which are not subprime, CSBS encourages the Board to promulgate a rule to require the lender to disclose to the borrowers being offered a stated income loan that they may qualify for a lower rate if income verification is provided.

Unaffordable Loans

As with the Nontraditional Guidance and the Subprime Statement, CSBS believes the Board should establish a requirement that a mortgage lender must consider the borrower's ability to repay the loan at the fully-indexed rate, based upon a fully-amortized payment schedule. This ability to repay determination should include consideration of taxes and insurance, as mentioned in the Subprime Statement. In addition, this ability to repay should be based on the consideration of total monthly debt obligations (the "back-end" ratio), not simply the housing-related expenses (the "front-end" ratio) as indicated in the Subprime Statement.

Disclosures

Ultimately, consumer disclosures must be improved. The current disclosure process is tedious, confusing, and encumbered by too many documents. Too many consumers have found themselves with payments they are unable to afford because they did not understand the loan terms and characteristics. A recent FTC study on disclosures identified that 95% of respondents could not identify the amount of a prepayment penalty using current required disclosures.

CSBS commends the Board for their recent proposed changes to Regulation Z with regards to open-end credit that is not home-secured. We understand the Board is currently engaged in a review of disclosures for home-secured credit. CSBS urges the Board to expedite their review in order to provide meaningful and concise disclosure as quickly as possible.

Creating a Standard Subprime Loan

As mortgage products continue to evolve at a rapid pace, it is difficult for even the most sophisticated borrowers to fully comprehend the terms and characteristics of their mortgage loans. In recent years, many subprime borrowers have purchased loans with terms they do not fully understand. While we believe improved disclosure forms will alleviate some borrower confusion, more should be done to ensure consumer protection.

Therefore, CSBS recommends that the Board consider a rule in which subprime consumers are offered a standard loan. The loan would have terms and characteristics that are most conducive to long-term or sustainable home ownership. This standard mortgage loan would be a 30-year fixed rate, fully amortizing, full documentation loan. The rule could provide for an affirmative opt-out with notification of the availability of independent financial counseling for any loan other than the standard 30-year, fixed rate, fully amortizing, full documentation loan.

Prepayment Penalties

Prepayment penalties can have a legitimate risk management purpose. Unfortunately, they can also be used in ways which are harmful to consumers. State regulators have varied views and experiences on their need, purpose, and effective and reasonable use. Realizing the complexity of this issue and potential impact on the broader mortgage market, state regulators will continue to cultivate the experiences at the local level and work to develop a formal recommendation to the Federal Reserve.

III. Conclusion

The residential mortgage market is constantly evolving and innovative products are constantly being developed. As financial regulators, therefore, we must identify those loan terms and characteristics that are most egregious to borrowers. These practices must be quickly identified and combated to protect consumers, and ensure the health of the mortgage industry and our economy as a whole.

For years, the state banking system has been the laboratory for innovation and for developing the best practices in products and services and consumer protection. The states, through coordinated initiatives like the CSBS-AARMR Nationwide Mortgage Licensing System, the Model Examination Guidelines, and the Model Disclosures, continue to innovate as the mortgage market evolves. At the same time, the states believe strong cooperation with federal regulators, such as our pilot examination project with the Board, the Office of Thrift Supervision (OTS), and the Federal Trade Commission (FTC), and our collaboration on recent regulatory guidance and pronouncements, is essential to a sound regulatory structure. We look forward to working with the Board to update the regulation of the mortgage market to protect consumers while encouraging sustainable homeownership.

Thank you for the opportunity to comment. Our members are prepared to support implementation of Board rulemaking in our examination and supervision efforts. We look forward to future cooperation and coordination as the mortgage industry continues to evolve.

Best Personal Regards,

A handwritten signature in black ink, appearing to read "Neil Milner". The signature is fluid and cursive, with the first name "Neil" and last name "Milner" clearly distinguishable.

Neil Milner
President and CEO

Appendix

CSBS/AARMR Nationwide Mortgage Licensing System

Improving Supervision of the Mortgage Industry through Collaboration and Technology

In order to protect their citizens and bring greater accountability and transparency to the mortgage industry, state mortgage regulators have been working together since 2004 to develop the Nationwide Mortgage Licensing System that will increase and centralize information available to state regulators, the industry and the general public about the people and companies that originate and make home mortgages.

Supervision of the mortgage industry began at the state level and last year alone, state mortgage regulators took over 6,000 enforcement actions against mortgage companies and professionals. The modern evolution of the mortgage industry and the increased importance of protecting consumers and neighborhoods, though, are signs that states' historic role demands new tools and authorities.

Building a Modern System of Oversight for the Mortgage Industry

State regulators have worked through their professional organizations, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR), to develop four uniform mortgage licensing forms that gather comprehensive information about mortgage lenders, bankers, and brokers, their owners and executive officers, branches, and loan officers:

- Uniform Mortgage Lender/Mortgage Broker Form (Form MU1)
- Uniform Mortgage Biographical Statement & Consent Form (Form MU2)
- Uniform Mortgage Branch Office Form (Form MU3)
- Uniform Individual Mortgage License/Registration & Consent Form (Form MU4)

Starting in January 2008, each state licensed mortgage lender, banker, and broker company will electronically complete a single Form MU1 (regardless of the number of states they are licensed in) and each of their owners and executive officers will complete a single Form MU2 (regardless of the number of companies they are affiliated with). This information will be housed in a centralized database available to state mortgage regulators. Licensees will be able to electronically access their own record over a secure website to amend their record, renew their licenses, or apply for a new license.

Likewise, each mortgage company branch and each loan officer will electronically complete a single Form MU3 or Form MU4 (respectively) for use in those states that require branch and/or loan officer licensing.

Increasing Transparency and Accountability in the Mortgage Industry

As each mortgage company, owner or executive officer, branch and loan officer completes a record for themselves and submits it to their regulator, the Nationwide Mortgage Licensing System will assign that record a unique identifying number. This number will be permanently assigned to the entity or person in perpetuity and will definitively allow state regulators to track companies and persons across states and over time.

Additionally, consumers and the mortgage industry will be able to check on the license status and license history of the companies and/or persons they wish to do business with.

The Status of the Nationwide Licensing System

As of July 2007, 35 state agencies have signed onto a Statement of Intent indicating their commitment to participate in the CSBS/AARMR Nationwide Mortgage Licensing System ("the System"). The System will begin operations on January 2, 2008. It is expected that 4-6 state agencies will transition onto the System on approximately a quarterly basis during 2008 and 2009. Each state will individually announce its participation date and communicate with licensees in advance of its participation onto the System.

In 2005, CSBS and AARMR formed a Residential Mortgage Regulator Taskforce (RMRT) that has met monthly to create the uniform applications and discuss functionality and regulatory matters that are being incorporated into the System. Currently, eleven states are using the MU Forms in paper format.

In 2006, a contract was signed with the Financial Industry Regulatory Authority (FINRA), formerly the National Association of Securities Dealers (NASD), to build the System. FINRA has tremendous experience in operating nationwide licensing and database systems for the securities and investment advisory industries and has an impeccable record of managing and protecting information.

Licensees and applicants will be able to access the System through a secure website over the Internet to create a record and manage all of their state mortgage license authorities. Licensees will be able to apply for, amend, renew, and surrender one or more licenses using their single record in the System. The System also provides for a streamlined license renewal and annual report process.

In September 2006, CSBS formed a wholly owned operating subsidiary called the State Regulatory Registry LLC (SRR) to develop and operate the licensing System. SRR is governed by a Board of Managers comprised of five state mortgage regulators that are members of CSBS and AARMR. In March 2007, the SRR Board of Managers amended the operating agreement to create a Mortgage Advisory Council comprised of industry companies and associations. The purpose of the Mortgage Advisory Council is to advise and assist the SRR Board of Managers in providing substantive input on appropriate areas of SRR activities.

Raising Standards and Garnering Efficiencies

A result of states' collaborative efforts in building the Nationwide Mortgage Licensing System is the raising and standardizing of licensing requirements. In adopting the uniform forms, states have reviewed their requirements accepting higher reporting standards incorporated into the forms and eliminating unnecessary requirements. Additionally, states are expanding the authority to conduct criminal background checks on their licensees.

Additionally, the SRR announced in the fall of 2006 an initiative to create improved educational and testing requirements across states. The initiative, named the Mortgage Industry National Uniform Testing and Education System (MINUTES), is a

complementary initiative of the Nationwide Mortgage Licensing System that will increase standardization of educational and testing requirements and improve compliance.

Contact

If you would like more information about the nationwide licensing system, please contact Tim Doyle at (202) 728-5728 or tim.doyle@csbs.org or Bill Matthews at (202) 728-5711 or bill.matthews@csbs.org.

Statement on Subprime Mortgage Lending

The Statement on Subprime Mortgage Lending (Subprime Statement) which was released by the federal financial regulators on June 29, 2007, was developed to address emerging risks associated with certain subprime mortgage products and lending practices. However, the interagency Subprime Statement does not apply to state-supervised mortgage lenders and mortgage brokers. Therefore, CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA) developed a parallel Subprime Statement that applies to state-supervised mortgage providers in order to promote consistent underwriting and consumer protection standards in the residential mortgage industry. To date, 27 state mortgage regulators have either adopted the Subprime Statement or announced their intention to expedite implementation of the Subprime Statement.

Guidance on Nontraditional Mortgage Product Risks

Prior to the release of the interagency Subprime Statement, the federal financial agencies issued the Guidance on Nontraditional Mortgage Product Risks (Nontraditional Guidance). The Nontraditional Guidance also does not apply to state-supervised mortgage lenders and brokers. Therefore, CSBS and AARMR developed parallel Nontraditional Guidance that applies to state-supervised mortgage providers. To date, 35 state mortgage regulators have adopted the Nontraditional Guidance.

Model Examination Guidelines

CSBS and AARMR have developed Model Examination Guidelines for use by state agencies that regulate residential mortgage lenders and brokers. The purpose of the guidelines is to provide state regulators with a uniform set of examination tools to conduct examinations under both the Guidance on Nontraditional Mortgage Product Risks (Nontraditional Guidance) and the Subprime Statement. Released on July 31, 2007, the guidelines are intended to:

- Protect consumers by providing comprehensive examination procedures that states can use to determine compliance with the Nontraditional Guidance and the Subprime Statement;
- Establish uniform standards applicable for multi-state examinations and enforcement actions; and
- Provide consistent and uniform guidelines for use by broker and lender in-house compliance and audit departments.

Draft Model Disclosure Form

CSBS is also developing a model disclosure form. While still a work in progress, the model disclosure form is intended to serve as an impetus for future discussion and debate as we move towards more meaningful disclosures. CSBS recognizes that disclosure is not a panacea for the problems currently experienced in the subprime mortgage market, but clear and meaningful information for consumers will go a long way towards empowering and protecting consumers.